DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 02-0312
Indiana Corporate Income Tax
For the Tax Years 1990 through 1999

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ISSUES

I. Taxpayer's Qualifications to File Under Indiana's Financial Institution Tax: Conducting the Business of a Financial Institution.

Authority: IC 6-5.5 et seq.; IC 6-5.5-1-17(d)(1); IC 6-5.5-1-17(d)(2)(B); IC 6-5.5-3-1; IC 6-8.1-5-1(b); 45 IAC 17-2-1(a); 45 IAC 17-2-4(b), (c); 45 IAC 17-2-4(e)(2); IRS Rev. Rul. 55-540, § 162(4) 1955-2 CB 39; IRS Rev. Proc. 75-21, § 4, 1975-1 CB 715.

Taxpayer states that the Department erred in determining that taxpayer did not qualify to report its income as a Financial Institution and in determining that taxpayer should have been filing Indiana Corporation Income Tax Returns for 1990 through 1998.

II. Taxpayer's "Non-Filer" Status

Authority: IC 6-3-4-1; IC 6-8.1-1-1; IC 6-2.1-5-2; IC 6-8.1-5-2(a); IC 6-8.1-5-2(e); Germantown Trust Co. v. Commissioner of Internal Revenue, 309 U.S. 304 (1940); 45 IAC 15-3-2(d)(3); 45 IAC 15-5-7(f); Black's Law Dictionary (7th ed. 1999).

According to taxpayer, even if the Department is correct in determining that it should have been filing Indiana Corporation Income Tax Returns for 1990 through 1998, the Department is statutorily precluded from imposing additional corporate income tax for 1990 through 1997 on the ground that – having filed the FIT returns – taxpayer was a "filer." In addition, taxpayer argues that having accepted the 1990 through 1998 FIT returns, the Department is effectively estopped from belatedly deciding that it should have been paying corporate income tax during those years.

III. Lease Payments Subject to Gross Income Tax.

Authority: IC 6-2.1-2-2(a); Enterprise Leasing v. Indiana Dept. of Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002); Comdisco, Inc. v. Indiana Dept. of Revenue, No. 49T10-9903-TA-19, 2002 Ind. Tax LEXIS 93 (Ind. Tax Dec. 18, 2002); 45 IAC 1-1-10; 45 IAC 1-1-28; 45 IAC 1-1-49; 45 IAC 1-1-162; 45 IAC 1.1-1-3(6); 45

IAC 1.1-1-5; 45 IAC 1.1-1-22; 45 IAC 1.1-1-22(a)(4), (10); 45 IAC 1.1-2-10; 45 IAC 1.1-3-13; 45 IAC 1.1-3-13(b); 45 IAC 1.1-3-13(b)(1).

Taxpayer argues that money it received attributable to gas station lease payments was not subject to Gross Income Tax because the lease payments were not derived from Indiana sources.

IV. Including the Value of Leased Property in Taxpayer's Property Factor – Adjusted Gross Income Tax.

Authority: IC 6-3-2-1(b); IC 6-3-2-1(c); IC 6-3-2-1(l); Enterprise Leasing v. Indiana Dept. of Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002).

Taxpayer maintains that the audit, in calculating its adjusted gross income tax, erred by including in taxpayer's property factor the value of property leased in this state but not used by the taxpayer in this state.

V. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer argues that it is entitled to abatement of the ten-percent negligence penalty because its decision to file FIT returns was based upon instructions issued by and decisions made by the Department.

STATEMENT OF FACTS

Taxpayer began filing Indiana tax returns in 1985. In 1990, taxpayer filed an Indiana income tax return reporting and paying corporate income tax. Thereafter, taxpayer concluded that it should be filing Indiana Financial Institution Tax (FIT) returns. Having decided that this was the proper course, in 1992 taxpayer filed another 1990 return but this time filed a FIT return. In a letter accompanying the 1990 FIT return, taxpayer stated it was "changing the 1990 filing status from IT-20s (on a separate basis) to FIT-20 on a unitary basis . . . ." In that letter, taxpayer stated that it "[met] the FIT requirements." As a result of this substitute filing, the Department obligingly sent taxpayer a refund payment.

Taxpayer continued to file FIT returns for 1992 through 1999. Those returns were accepted by Department.

In 2001, the Department conducted an audit of taxpayer's business and tax records. In the report which followed that audit examination, the Department concluded that taxpayer "erroneously filed Financial Institution Franchise Tax Returns" for 1990 through 1999. Having arrived at the conclusion, the Department designated taxpayer as a "non-filer." The "non-filer" designation enabled the Department to go back to 1990, calculate Indiana corporate income taxes for those years, and assess back taxes for 1990 through 1999.

Taxpayer disagreed with the Department's conclusion on multiple grounds and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer explained the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Taxpayer's Qualifications to File Under Indiana's Financial Institution Tax: Conducting the Business of a Financial Institution.

Taxpayer maintains that it was entitled – at all times relevant – to file FIT returns because taxpayer "derived at least 80 [percent] or more of its gross income (excluding extraordinary income) from making acquiring, selling or servicing loans or extensions of credit and leasing real and personal property that is the economic equivalent of the extension of credit." Taxpayer describes itself as a "multifaceted supplier of financial services to customers in a variety of industries."

According to taxpayer – for purposes of calculating its federal and FIT tax liability – taxpayer received lease payments attributable to an arrangement it had entered into with a trust (hereinafter, the "trust company") and an oil company affiliate. According to taxpayer, this is how the arrangement worked:

1. Oil company affiliate decided to build gas stations.

2. With an eye toward providing long-term financing for those gas stations, taxpayer supplied money to the trust company. Other third-party investors also provided money to the trust company. In actual practice, all of this money was held on a short-term basis by an indenture trust.

3. After oil company affiliate completed construction of the gas stations, it sold all the stations to the trust company. The oil company affiliate used the proceeds to pay off the initial cost of building the gas stations.

4. The oil company affiliate then leased the gas stations back from the trust company. Taxpayer describes this agreement – between the oil company affiliate and the trust company – as a "sales/leaseback."

5. Thereafter, the oil company affiliate made lease payments to the trust company for the right to use and operate the same gas stations it had originally designed, built, and briefly owned.

The issues raised all stem from the lease payments and the manner in which these payments should be treated for FIT and Indiana gross income tax purposes. According to taxpayer, the trust company was a "grantor trust," and – at least for federal income tax purposes – the trust company was entirely transparent; for federal income tax purposes, taxpayer treated the lease payments as if those payments were received directly from the oil company affiliate. For federal income tax purposes, taxpayer was entitled to claim the depreciation on the gas stations and pay no federal income tax on the lease payments. Accordingly, taxpayer argues that it was entitled to be treated as a "Financial Institution" for Indiana tax purposes. The audit disagreed, concluded that taxpayer was not entitled to be treated as a "Financial Institution," and that taxpayer should have been filing Indiana corporate income tax returns.

Indiana imposes a franchise tax, known as the Financial Institution Tax (FIT), on corporations transacting the business of a financial institution inside the state. IC 6-5.5 et seq. The tax is imposed on resident financial institutions, on nonresident financial institutions, and on non-bank entities that transact the business of a financial institution. 45 IAC 17-2-1(a). Non-resident corporations, such as the taxpayer, transacting the business of a financial institution, are included in the FIT when they meet one of the eight tests listed in IC 6-5.5-3-1 whereby the non-resident corporation demonstrates that it has established an economic presence in Indiana. It is not disputed that taxpayer established an "economic presence" within the state because the service stations were located in Indiana.

Because the taxpayer is not conducting the business of a traditionally regulated financial institution as defined in IC 6-5.5-1-17(d)(1), the taxpayer bases its claim to FIT status under the provisions of IC 6-5.5-1-17(d)(2)(B) which grants FIT status to those corporations which obtain 80 percent of their gross income from the "leasing [of] real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes." Id.

That definition is amplified in the Department of Revenue regulations. A corporation is subject to the FIT if it is conducting the business of a financial institution. 45 IAC 17-2-4(b), (c). The benchmark for determining whether the taxpayer is conducting the business of a financial institution is if 80 percent of the corporation's gross income is derived from the economic equivalent of extending credit. Id. The corporation must not only derive 80 percent of its income from garnering interest, that interest must be derived from a lease that is "*not* treated as a lease for federal income tax purposes." 45 IAC 17-2-4(e)(2) (*Emphasis added*). Therefore, to satisfy the 80 percent benchmark, the interest must be both "the economic equivalent of the extension of credit" and from a lease "*not* treated as a lease for the federal income tax purposes." Id.

The taxpayer, looking to qualify as a FIT filer, is required to demonstrate that the transactions from which it derives interest income are not true leases but financing leases. A financing lease appears on the surface to be a lease and may be labeled as such; however in reality it is simply a device which enables the lessor (seller) to retain a security interest in the property until the purchase price is paid by the lessee (buyer). In effect, under a financing lease, the lessor is making a conditional sale to the lessee. IRS Revenue Ruling 55-540 provides the guidelines used in determining the treatment of leases for use in the trade or business of the lessee. Whether a lease agreement is a lease, or in reality a conditional sale, depends on the provisions of the agreement in light of the facts and circumstances existing at the time the agreement was executed. Rev. Rul. 55-540, § 162(4) 1955-2 CB 39. In the "absence of compelling persuasive factors" demonstrating otherwise, a transaction is a conditional sales contract if one or more of the following factors are present:

(1). Portions of the periodic payments are specifically applicable to the equity to be acquired by the lessee;

(2) the lessee acquires title upon a payment of a stated amount of rentals which under the contract the lessee is required to make,

(3) the total amount paid by the lessee for a relatively short period of use constitutes an inordinately large proportion of the total payments required to secure transfer of title,

(4) the rental payments materially exceed the fair rental value,

(5) the property can be acquired under a purchase option at a price which is nominal in relation to the value of the property at the time the option may be exercised or which is a relatively small amount when compared to the total,

(6) some portion of the payments is specifically designated as interest or is otherwise recognizable as the equivalent of interest. Id.

IRS Revenue Procedure 75-21 expands on Revenue Ruling 55-540 by elaborating on the facts and circumstances that indicate whether a transaction is, in contrast to a conditional sale, a true lease. A transaction will constitute a true lease if *all* of the following conditions are met;

(1) The lessor must have a minimum unconditional risk investment in the property at the inception of the transaction,

(2) the lessor must maintain the minimum at risk investment throughout the lease and that risk must remain at the end of the lease,

(3) the minimum at risk investment must be equal to at least 20% of the cost of the property and must remain at 20% throughout the entire lease term,

(4) and, there must be a residual investment of at least 20% at the end of the lease term. Rev. Proc. 75-21, § 4, 1975-1 CB 715.

The taxpayer must meet its burden of proof by demonstrating that the proposed tax assessment, requiring the taxpayer to file under IT-20, is incorrect. IC 6-8.1-5-1(b) states in relevant part that "[t]he notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with person against whom the proposed assessment is made."

The money taxpayer receives from the oil company affiliate – by way of the trust company – is not money received from financing leases. Taxpayer is simply investing money in an entity which provides long-term financing for the construction of gas stations and then holds those gas stations in a sales/leaseback arrangement. Even if the trust company and the sub-trust were taken out of the picture and the Department was to treat taxpayer's income as if it was received directly from the oil company affiliate, the taxpayer would still not be entitled to FIT treatment because these gas station leases are not "conditional sales" of the service stations. There is no indication that any of the money oil company affiliate pays goes to purchasing equity in the station; there is no indication that the oil company affiliate will ever reacquire title to the service station simply by making a stated amount of rental payments. Even after considering or ignoring entirely the relationship and the obligations between all of the participants – the oil company affiliate, taxpayer, the trust company, and the sub-trust – taxpayer is not entitled to FIT status because none of the participants were engaged in "the economic equivalent of extending credit."

There is no indication that taxpayer's interest income is received from transactions which qualify as conditional sales under IRS Revenue Ruling 55-540 or that the income is not simply derived from true leases under Revenue Procedure 75-21. Taxpayer is not in the business of extending credit and may not submit a FIT return.

FINDING

Taxpayer's protest is respectfully denied.

II. Taxpayer's "Non-Filer" Status

Assuming that taxpayer was not entitled to submit FIT returns, taxpayer nonetheless argues that the Department may not assess corporate income taxes for 1990 through 1997 because the three-year statute of limitations has run for those eight years. The audit concluded that the three-year limitations period had not run because – having submitted the incorrect tax returns – taxpayer was a "non-filer;" submission of the incorrect returns did not begin the running of the limitations period.

A. Three-Limitations Period.

The limitations period is defined under IC 6-8.1-5-2(a) which states that, "Except as otherwise provided in this section, the department may not issue a proposed assessment under section 1 of this chapter more than three (3) years after the latest of the date the return is filed . . . ." IC 6-8.1-5-2(e) defines certain circumstances under which three-year limitations is tolled. "If a person files a fraudulent, unsigned, or substantially blank return, of if a person does not file a return, there is no time limit within which the department must issue its proposed assessment."

There is no contention taxpayer submitted fraudulent FIT returns. There is no contention taxpayer submitted unsigned or substantially blank returns. Instead, the audit based the assessment on the conclusion that taxpayer did "not file a return." If, as taxpayer contends, the submission of the FIT returns began running the three-year limitation under IC 6-8.1-5-2(a), taxpayer could only be assessed additional taxes for 1998 and 1999.

Taxpayer cites to Germantown Trust Co. v. Commissioner of Internal Revenue, 309 U.S. 304 (1940) in support of its argument, that the filing of the FIT-20 returns started the three-year limitations period. In Germantown Trust, the Court held that the two-year limitations period under Rev. Act. 1932, § 275(a), precluded the Internal Revenue Service from making a deficiency assessment against the petitioner. On behalf of its trust patrons, the petitioner had originally filed a "fiduciary return" but failed to file a corporate return reporting the petitioner's own income. Four years later, the IRS prepared a substitute corporate return and gave notice of the petitioner's tax deficiency. The IRS argued that the filing of the fiduciary return was the equivalent to "no return of the tax" under Rev. Act. 1932, § 275(c) which provided an extended four-year limitations period. The Court rejected the government's contention and agreed with the petitioner because petitioner's fiduciary return "contained all of the data from which a tax could be computed and assessed [even though] it did not purport to state any amount due as tax." Id at 307.

Taxpayer contends that its position is similar to that of the petitioner in Germantown Trust. Taxpayer states that the FIT returns submitted during 1990 through 1997 provided the Department with all the information that was needed for the Department to determine taxpayer should have been filing corporate income tax returns. Taxpayer concludes that because the Department had all the information it needed at the time of the original filings, it cannot at this late date assess the additional income taxes in the face of the three-year limitations period.

The Department must respectfully disagree with taxpayer's conclusion. Even assuming for the moment that the wayward FIT returns contained information sufficient to place the Department on notice that taxpayer should have been filing corporate income tax returns and imposed on the Department the obligation to inform taxpayer of its responsibilities under the Indiana tax laws, the three-year limitations period does not bar the Department from assessing the additional taxes here at issue. Indiana's regulation states that, "The running of the statute of limitations for purposes of assessing unpaid taxes will not start if the taxpayer fails to file a return which is required by any listed tax provision." 45 IAC 15-5-7(f). The term "listed tax" is defined at IC 6-8.1-1-1 which specifically includes "the gross income tax . . . the adjusted gross income tax . . . [and] the supplemental net income tax" as three of the state's "listed taxes." Taxpayer had an obligation to file returns and report the three "listed taxes." IC 6-3-4-1 states that, "Returns with respect to taxes imposed by this act *shall be made*. . . ." (*Emphasis added*). *See also* IC 6-2.1-5-2. "Every taxpayer who receives more than one thousand dollars ($1,000) in gross income during a particular taxable year *shall file* with the department an annual gross income tax return." (*Emphasis added*).

Taxpayer does not stand in same shoes as that of the petitioner in Germantown Trust. In that case, the Court was interpreting the applicability of the limitations period set out in Rev. Act. 1932, § 275(a). In this instance, taxpayer incorrectly determined it was entitled to submit FIT returns. However, the submission of the FIT returns did not begin the running of the three-year limitations period because, under 45 IAC 15-5-7(f), taxpayer had an obligation to file corporate income tax returns. For purposes of determining its responsibility under the Indiana corporate tax laws, taxpayer was a "non-filer."

B. Equitable Estoppel.

Taxpayer argues that even if the three-year limitations period was not tolled by the submission of the FIT returns, the Department is nonetheless precluded from assessing the additional taxes because it acquiesced to the taxpayer's 1992 decision and because the Department may not change its position without first having given taxpayer notice of that decision.

Taxpayer points out that it notified the Department of its decision to file FIT returns in 1992, and that the Department "affirmatively approved the filing change by granting [taxpayer] a refund of the income tax paid." In addition, taxpayer points out that the Department's instructions on the corporate income tax returns and the FIT returns specifically instruct the filer to submit either an IT-20 return or an FIT-20 return but that the filer should not submit both. Taxpayer concludes that, "In short, the Department agreed with [taxpayer's] position that it should file financial institutions tax returns."

Essentially, taxpayer argues that it relied on the Department's past acquiescence to the decision to submit FIT returns and that the Department is now estopped from belatedly changing that position. Taxpayer is interposing the defense of "equitable estoppel." Equitable estoppel is a defensive doctrine which "prevents one party from taking unfair advantage of another when, through false language or conduct, the person to be estopped has induced another person to act in a certain way . . . ." Black's Law Dictionary 571 (7th ed. 1999).

The taxpayer's argument is unwarranted because there is no indication taxpayer sought or received advice from the Department concerning its filing status. There is no indication the Department "agreed" that the taxpayer was entitled to file the FIT returns. There is no indication the Department induced taxpayer into incorrectly believing it was entitled to submit FIT returns. There is no indication that the Department is taking unfair advantage of the taxpayer after having affirmatively misled taxpayer as to its tax liability. Under 45 IAC 15-3-2(d)(3), taxpayer was entitled to seek, obtain, and rely on a ruling from the Department as to its tax status. Taxpayer chose not to do so but made an erroneous decision to submit FIT returns and unilaterally inform the Department that it "[met] the FIT requirements." During the years at issue, taxpayer enjoyed the advantage of owing zero Indiana tax liability. However belatedly, taxpayer must now live with the consequences of that decision.

FINDING

Taxpayer's protest is respectfully denied.

III. Lease Payments Subject to Gross Income Tax.

Taxpayer argues that it did not incur gross income tax liability during the years covered by the audit report. Taxpayer bases this argument on the fact that the audit assessed gross income tax on the rental income taxpayer received from the gas stations located in Indiana. However, taxpayer points out that it did not own the Indiana gas stations but that the trust company owned the gas stations. Taxpayer further states that it did not receive the lease payments but that the trust company received the payments.

Taxpayer sets out a secondary argument. Even if the lease payments were subject to gross income tax, taxpayer concludes that it can only be liable for gross income tax "on an apportioned share of the trust's distributable net income, which during the years 1990 – 1996 was a negative number – *i.e.* a loss."

A. Trust Income.

Taxpayer's wholesale conclusion that trusts are not subject to the state's gross income tax is not well taken.

45 IAC 1-1-162 provides as follows:

> Business Trusts. Generally, trusts are not taxpayers under the Gross Income Tax. However, if a trust resembles a corporation in form and has its purpose the conduct of a business, it is considered an association and is taxed as a corporation. A trust with these features is taxable as a corporation:
>
> > (1) The trustee(s) exert centralized management over the trust property;
> >
> > (2) Ownership in the trust is transferable;
> >
> > (3) The owners' liability is limited to the trust property; or
> >
> > (4) The trust has perpetual life.

45 IAC 1-1-162 is applicable to the trust company's 1990 through 1998 income but was replaced by 45 IAC 1.1-1-22 which states that for purpose of the state's gross income tax, "taxpayer" includes both "[a] business trust as defined in IC 23-5-1-2." and "[a] fund, account, or trust treated as a corporation under Section 468B of the Internal Revenue Code or its accompanying regulations." 45 IAC 1.1-1-22(a)(4), (10).

45 IAC 1.1-1-22 is relevant to the income received by the trust company during 1999.

Under either the previous or the more current gross income tax regulatory regime, the income received by certain trust arrangements is subject to Indiana gross income tax. The Department must disagree with taxpayer's conclusion that a trust cannot be a "taxpayer" for gross income tax purposes.

B. Distributable Net Income.

Taxpayer argues that even it is subject to gross income tax, it is only subject a tax on the "distributable net income" received from the trust company. Because – according to taxpayer's calculation – the amount of "distributable net income" was a negative number, taxpayer owes no gross income tax.

As the basis for this conclusion, taxpayer cites to 45 IAC 1.1-3-13 which states in part:

> Each corporate beneficiary of the trust shall report for gross income tax purposes its proportionate share of the following income:
>
> (1) Distributable net income determined under section 643 of the Internal Revenue Code.

> (2) An accumulation distribution determined under Section 665 of the Internal Revenue Code.
>
> (3) Undistributed capital gain, determined without regard to capital losses, not otherwise included in the distributable net income as determined under Section 665 of the Internal Revenue Code. This amount shall be determined before any taxes imposed on the trust attributable to such income. 45 IAC 1.1-3-13(b).

Taxpayer relies exclusively on the "distributable net income" language found under 45 IAC 1.1-3-13(b)(1). However, it is apparent that the regulation did not intend the cited language to be exclusive. Rather the regulation – under certain circumstances – brings both "an accumulation distribution" and "undistributed capital gain" within the purview of the gross income tax.

In addition, the cited regulation applies only to the income taxpayer received from the trust company during 1999. The taxpayer has not fully developed its "distributable net income" argument regarding the 1990 through 1998 assessments.

The Department is unable to agree with taxpayer's conclusion that it was subject to gross income tax only on the distributable net income tax received from the trust company during 1990 through 1999.

C. Indiana Source Income.

Taxpayer argues that the money it received – attributable to lease payments for Indiana gas stations – was not Indiana source income for gross income tax purposes.

In support, taxpayer cites to Enterprise Leasing v. Indiana Dept. of Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002). In that case, the Tax Court found that an out-of-state company did not receive Indiana source income when it rented Indiana-titled cars to its customers; therefore, the rental income was "not subject to Indiana's gross income tax." Id. at 1292.

In addition, taxpayer cites to Comdisco, Inc. v. Indiana Dept. of Revenue, No. 49T10-9903-TA-19, 2002 Ind. Tax LEXIS 93 (Ind. Tax Dec. 18, 2002), in which the court found that income received from leasing "high technology and medical equipment" to customers within Indiana was not subject to gross income tax. Id. at *5.

IC 6-2.1-2-2(a) imposes the gross income on the receipt of "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or domiciliary or Indiana." However, the Tax Court has found that certain rental income received from Indiana customers is not Indiana source income for gross income tax purposes.

In Enterprise, the court found that that money received from renting Indiana titled cars was not Indiana source income because it was not the petitioners who decided to register and operate the cars within the state. Enterprise 779 N.E.2d at 1291. Rather, it was the decision of the individual customers to register and operate the cars in Indiana. Id. The petitioners' activities in sending the cars to its customers "did not rise to the level of 'active participation' in the 'ownership, leasing' or rental' of property in Indiana." Id. The court determined that the "critical transaction" occurred related to the leasing of the cars occurred at the petitioners' out-of-state location. Id. at 1230.

Similarly, in Comdisco the court found that the petitioners' only Indiana activity was "ownership of high technology equipment that [was] located pursuant to the lessees' direction." Comdisco, 2002 Ind. Tax LEXIS 93 at *22.

The Department does not find that the decisions in Comdisco and Enterprise are dispositive of the question of whether lease payments received from gas stations located within Indiana are subject to gross income tax. In both those cases, the fact that the tangible personal property happened to be located within Indiana was unrelated to the "critical transaction" which formed the basis for the petitioners' income. In taxpayer's situation, the lease payments are derived from real property located within this state. The connection between Indiana and the leased gas stations is inherent in the nature of real property and is not simply the result of sheer happenstance or the lessees' unilateral decisions to locate the gas station within Indiana. The connection between the Indiana gas stations and the lease payments cannot be avoided by the fact that the lease agreements were executed at an out-of-state location or that the lease payments were directed to an out-of-state location.

Taxpayer's argument to the contrary, the analysis seems fairly straightforward. 45 IAC 1-1-49 states that, "[A] taxpayer may establish a 'business situs' in ways including, but not limited to, the following: (6) Ownership, leasing, rental or other operation of income producing (real or personal)." *See* 45 IAC 1.1-1-3(6). Taxpayer receives lease income attributable to gas stations located within Indiana. 45 IAC 1-1-28 provides that the income derived from "the lease or rental or real or tangible personal property, whether actually or constructively received are taxable at the high rate . . . ." *See* 45 IAC 1.1-2-10. Income which is "constructively received" includes "items of gross income which are not actually received by the taxpayer but which are credited to him, available for his benefit, or represent income to which he is entitled." 45 IAC 1-1-10; *See* 45 IAC 1.1-1-5.

By means of its arrangement with the trust company and the oil company, taxpayer received income attributable to the leasing of gas stations located within Indiana. The Department disagrees with taxpayer's conclusion that it did not receive Indiana source income and that the income is not subject to the state's gross income tax.

FINDING

Taxpayer's protest is denied.

IV. Including the Value of Leased Property in Taxpayer's Property Factor – Adjusted Gross Income Tax.

Taxpayer argues that the audit review miscalculated its adjusted gross income tax liability by including the value of the leased gas station in its property factor.

Indiana imposes the adjusted gross income tax on each corporation's adjusted gross income derived from sources within this state. IC 6-3-2-1(b). Where a corporation – such as taxpayer – receives income from both Indiana and out-of-state sources, the amount of tax is determined by the apportionment formula set out in IC 6-3-2-1(b). That formula operates by multiplying taxpayer's total business income by a fraction composed of a property factor, a payroll factor, and a sales factor. IC 6-3-2-1(b). In this instance, taxpayer argues that the gas station properties should not have been included in the property factor.

The property factor is a fraction, "the numerator of which is the average value of the taxpayer's real and tangible personal property owned and rented and used in this state during the taxable year . . . ." IC 6-3-2-1(c). Under taxpayer's calculation, reducing the property factor numerator to "zero" would have the effect of reducing taxpayer's adjusted gross income tax liability to "zero." Taxpayer argues that it did not "use" the Indiana gas stations and points to the Tax Court's decision in Enterprise 779 N.E.2d at 1294 to support its argument that the gas stations should be excluded from the property factor numerator.

Setting aside the question of whether the Enterprise decision – dealing with the issue of whether the value of rental cars should be included in the property factor numerator – is relevant to the real property at issue here, the Department concludes the audit was correct in apportioning taxpayer's income based, in part, on the value of the leased gas stations. Clearly, taxpayer received income attributable to the Indiana gas station locations. Taxpayer's contention that these gas station properties should be eliminated from the apportionment factors would have the effect of eliminating taxpayer's Indiana income tax liability on the ground that it did not "use" these properties. The Department finds little support for such a result in fact, law, or common sense.

IC 6-3-2-2(l) provides as follows:

> If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or *the department may require* in respect to all or any part of the taxpayer's business, if reasonable . . . (3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana . . . ." (*Emphasis added*).

The Department does not agree with the notion that disregarding entirely the value of the gas station properties would "fairly represent the taxpayer's income." The audit's decision to include the value of Indiana properties was entirely appropriate in order to "fairly represent the taxpayer's income derived from sources with the state of Indiana . . . ." Id.

FINDING

Taxpayer's protest is respectfully denied.

V. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer maintains that the ten-percent negligence penalty should be abated because based upon "instructions issued by the Department, the actions of the Department and the relevant facts" its tax reporting was not negligent.

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Although unwilling to agree that the taxpayer's tax reporting errors were the result of actions or instructions attributable to the Indiana Department of Revenue, the Department agrees with taxpayer that the positions it took in regard to its Indiana tax liabilities – however erroneous – were indicative of "reasonable cause and not due to willful neglect."

FINDING

Taxpayer's protest is sustained.

DK/JM/MR – 030409